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Month in Cash: Weary savers see some light at end of very long tunnel

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Cash yields finished February virtually unchanged from January as investors looked to the Federal Reserve for clues about when interest rates would finally begin to rise. In both word and deed, there was much to consider. Early in the month, Fed Chairman Ben Bernanke hinted that the central bank would soon take a tentative (if mostly symbolic) step towards normalizing policy by raising the discount rate, or the price that banks pay for Fed loans. One week later, Bernanke followed through on his pledge, moving the discount rate higher by 25 basis points to 0.75%. Even at that marginally elevated level, however, it is still below the traditional 100 basis-points premium over the benchmark fed funds rate, which remained near the middle of the Fed's zero to 0.25% target range. In subsequent testimony to Congress, Bernanke repeated his intention to keep interest rates low for an extended period.



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Though an increase in the discount rates does nothing to make cash yields more attractive, we view it as the beginning of a process that eventually will lead to that end. In effect, the virtually free-money policies that have penalized and frustrated savers over the last two years might be compared to speeding in the left lane of a superhighway; the discount rate hike is akin to turning on the right-hand blinker, thus signaling the intention to exit the fast lane—and eventually the highway itself—even though the exit ramp is still an indefinite ways off.

Meanwhile, the Fed is likely to take additional measures of a largely technical nature, including ending its massive purchases of mortgage-backed securities and using assets on its balance sheet as collateral to drain reserves from the banking system through reverse repurchase agreements. The reverse repo program should at least push overnight cash rates towards the upper end of the Fed's super-low target range. Yet with excess capacity remaining in domestic labor and product markets, policymakers have latitude to wait before raising the funds rate, which serves as the basis for yields on cash equivalents. In fact, core consumer prices fell in January for the first time since 1982, and U.S. economic growth appeared to weaken markedly amid poor weather in February.

With no significant or lasting changes in the yield curve—three-, six- and 12-month London interbank offered rates (Libor) finished the month at 0.25%, 0.39%, and 0.84%, respectively—we believe the prudent course at this nascent stage of the economic recovery is to nibble opportunistically across the yield curve in response to market reactions to the daily flow of economic data and Fed activity.

Views are as of March 2, 2010, and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security.

London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. Libor is fixed on a daily basis by the British Bankers' Association and acts as a benchmark for other short-term interest rates.

The cash-yield curve is a graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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